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Determining the Value of a U.S. Patent

Acquiring an expensive U.S. patent portfolio is a high stakes transaction that requires careful consideration. One of the toughest questions in an acquisition analysis is also the most basic question: "What is the patent or portfolio worth?" In the context of an infringement lawsuit, the value of a patent may be easier to quantify. You may understand the costs associated with the worst-case scenario (losing the case), the costs associated with achieving the best-case scenario (winning, but paying litigation fees), and may have a good sense of the risks associated with not settling the case. In contrast, a business transaction involving a patent acquisition or licensing deal has fewer concrete metrics for valuation. This causes acquirers to struggle with an inherently speculative valuation process. This article will provide some guidance.

The process of investigating the value of an asset to determine whether a transaction involving the asset makes sense is called "due diligence." The key word here "due." No matter how much time and effort you spend, it is unlikely you will determine a definite and precise valuation. Instead, the goal is to match your diligence effort to the size and needs of the transaction. In other words, you must determine how much diligence is "due," which will vary from one transaction to the next. For example, if you are just trying to avoid being sued or if you are acquiring a company with purely defensive patents, little diligence may be required. In contrast, where the value of a company is based on its ability to use its patents to exclude competitors from its market, such as pharmaceutical company with a new billion-dollar drug, extensive diligence is "due."

Here is a selection of basic diligence tasks that should be considered when determining what is "due" for a particular transaction:

- review USPTO assignment records: this will confirm the patent owner has title to the patents it is licensing or selling, free of all liens;
- review USPTO maintenance fee records and pending application status: this will show the patents are still in force and pending applications will give the acquirer flexibility to grow the patent portfolio;
- review all licenses granted by the patent owner: this can determine your ability to exclude by confirming that the patent owner has not licensed key competitors;
- review the patent owner's employment agreements: this will confirm all possible employee inventors have assigned all patent rights;
- review joint development agreements or by subcontractors: this will confirm that key technology is not owned by these third parties;
- review all correspondence between the patent owner and others offering to license patents or alleging infringement in the relevant technology areas: reviewing both claims against the patent owner and claims by the patent owner can determine the relative strength of the patent owners portfolio; and
- review all pending or past legal actions involving the patents or the targets products: this will shed light on the patent's real value, because that value is only truly tested in litigation.

For truly valuable patents, however, a next level of diligence is often warranted.

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Specifically, a patent's real value derives from its ability to either scare competitors away from a technology space (perceived value) or its ability to win the same results in a litigation (actual value). This question boils down mostly to the two most important facets of a patent.

First, what is the *scope* of the patent's claims? This question depends on the claims of the patents and their meaning, which can be complicated. Entire treatise volumes are dedicated to the rules for interpreting claims. Thus, a U.S.-trained lawyer familiar with patent law often needs to review and opine on the question of scope, which requires review of the back-and-forth between the patent applicant and the PTO.

Second, given the patent's scope, is it *valid*? This is probably the most complicated question in patent law, and parties can spend over a million dollars in a litigation resolving this issue. This requires research into the "prior art," the state of the patent's technology prior to its application date—whether prior patents, prior scientific publications, or prior products. This diligence is something akin to academic journal research, with a bit of archeology and history thrown in. (The author once succeeded in finding invalidating prior art by tracking down a Korea War veteran who helped innovate U.S. military communications technology.)

In summary, the true value of a patent or patent portfolio cannot be understood without an understanding its legal import, which can be an involved process. Thus, an acquiring company must put serious thought into determining the amount of analysis required for each transaction.

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